# Deputy Assistant Secretary for Fiscal Operations & Policy Gary Grippo Testimony Before the Senate Appropriations Subcommittee on Financial Services and General Government

Chairman Durbin, Ranking Member Collins, and members of the Subcommittee, thank you for inviting me to testify about the Federal government's costs of accepting credit and debit cards to collect Federal revenue.

The Federal government is among the largest entities that accepts payments by credit and debit card. My statements today reflect the interests of the Federal government acting as a participant in the national payment card system, and are not offered from the perspective of a policy maker commenting on financial regulatory reform or on the interests of commercial participants in the larger economy.

## OVERVIEW OF FEDERAL COLLECTIONS

The Treasury Department, through its bureau the Financial Management Service (FMS), centrally collects and deposits all Federal revenue on behalf of all Federal agencies. In Fiscal Year (FY) 2009, through a network of over 125 banks acting as financial agents to the Federal government, the Treasury processed 391 million collection transactions totaling nearly \$2.86 trillion in gross revenue. These transactions include collections for taxes, duties, fees, fines, sales of goods and services, leases, and loan repayments, among many other types of transactions. The largest customer of these centrally provided collection services is the Internal Revenue Service for individual and corporate income taxes, but 228 other agencies rely on the Treasury for collection and deposit services.

To process these collections, the Treasury maintains an infrastructure that allows individuals and organizations around the world to make payments to any Federal agency. This infrastructure uses all the settlement mechanisms available in the U.S. payments system, including wire transfers, Automated Clearinghouse (ACH) entries, credit and debit cards, checks and other paper drafts, and cash, as well as a number of cross-border payment mechanisms. The Treasury's collections infrastructure also includes some of the largest cash management systems in the world, such as the Electronic Federal Tax Payment System (EFTPS), which in FY 2009 processed \$1.9 trillion in tax collections though wire transfers and ACH entries from 11.5 million businesses and individuals enrolled in EFTPS. The Treasury maintains extensive government-wide customer service capabilities to help Federal agencies process the collections required under their programs, and to assist with the accounting and reconciliation of transactions.

The Treasury has several objectives in managing this global collections infrastructure. One objective is to minimize collection float and to settle funds into the Treasury's main account at the Federal Reserve as soon as possible after a transaction is authorized or initiated. Another goal is to process transactions at the lowest possible cost, while recognizing that in some cases transaction costs are driven by the statutory requirements of a Federal agency's program and may

not be discretionary. A third requirement is, of course, to timely and properly account for and report on the millions of transactions processed through the infrastructure. In measuring these goals, the Treasury monitors several important metrics, including the percentage of transactions conducted electronically versus through cash and checks, and the unit cost of collections, both by the cost per transaction and the cost per dollar collected.

# USE OF CREDIT AND DEBIT CARDS IN FEDERAL COLLECTIONS

Credit and debit cards are an important part of the Treasury's collections service, and Federal agencies increasingly rely upon them to support Federal programs and deliver services. Cards help meet the Treasury's cash management objectives by improving the accuracy and timeliness of Federal collections through the displacement of cash and checks. Cards afford citizens and small businesses with a convenient means of transacting with their government, particularly online at Federal agency web sites. Through a commercial bank acting as a financial agent to the Federal government, the Treasury allows Federal agencies to accept American Express, Discover, MasterCard, and Visa credit and debit cards, as well as PIN-based debit cards. Over 200 Federal agencies operating 4,350 point of sale locations currently accept cards. Examples of Federal programs for which cards are accepted include the Federal Communications Commission for radio operator licenses, the Centers for Medicare & Medicaid Services for individual Medicare premiums, the Federal Bureau of Investigation for Freedom of Information Act document fees, and the U.S. Mint for coin sales. In FY 2009, Federal agencies collected \$8.6 billion through 80.3 million credit and debit card transactions. Mirroring trends in the larger economy, the number of card transactions with Federal agencies has been steadily increasing, with an average annual growth rate of over 15% over the last five years. Note that these statistics do not include the U.S. Postal Service and non-appropriated Federal instrumentalities that manage their banking relationships outside of the Treasury.

# COST OF PROCESSING FEDERAL COLLECTIONS

The Treasury pays for the Federal government's collections infrastructure and bears the costs of processing transactions on behalf of Federal agencies, in part because only the Treasury or its designated agent banks, and not Federal agencies or their contractors, may legally hold public money. This centralized model ensures that the Federal government has the most efficient systems to take advantage of economies of scale, helps the Treasury enforce government-wide standards for financial transactions, and allows the Treasury to better manage the revenue side of government's daily cash position. In FY 2009, the Treasury spent \$561 million on the Federal government's collection and deposit infrastructure, which includes expenditures to pay for transaction and service fees to process collections received or authorized by mail, by phone, over-the-counter, over the Internet, and through banking networks.

Credit and debit cards represent the most expensive component of the infrastructure, costing \$116 million in interchange and card network fees, with an average transaction cost of \$1.45, in FY 2009. By contrast, EFTPS cost the Treasury \$65.7 million to process 101 million income tax transactions, for an average transaction cost of \$0.65, and the Treasury's general lockbox network, which processes paper check collections for all Federal agencies, cost \$22.4 million to

process 37 million items, for an average transaction cost of \$0.60. Card collections represent only 0.31% of total Federal revenue, but 20% of total collections costs. Interchange fees charged by card networks are the largest component of these card costs, with an average rate of 1.9% across all Federal credit card collections transactions in FY 2009. In contrast to a continuing decline in the unit cost of other collection mechanisms, moreover, this credit card interchange rate has remained relatively constant for many years.

As stated earlier, the Treasury and not each Federal agency pays for credit and debit card fees. Because these costs are borne centrally by the Treasury, the mechanism for paying them differs from the commercial model. Normally, a commercial merchant pays its card fees by means of a discount to its transactions. For example, if a merchant is charged card fees of 2%, a sales transaction of \$100 would result in a deposit of \$98 to the merchant when the card transaction settles, with \$2 withheld to cover the fees. When a Federal agency accepts a card payment for a \$100 transaction with a 2% card fee, however, the agency will receive a deposit at par of \$100 and the Treasury will be separately billed for a \$2 fee. Card fees for agencies across the Federal government are borne by the general fund of the Treasury, and any reductions to card costs would go directly to reducing the Federal deficit.

As a steward of taxpayer money, the Treasury has for some time been concerned about the relatively high cost of the Federal government's card transactions, and has taken several actions in recent years to help manage these costs. In FY 2006, when the Treasury solicited re-bids for government-wide card acquiring services, overall cost was the most important factor in selecting an acquiring bank. In 2005, the Treasury issued a bulletin to Federal agencies instructing them to limit their card collections to cashflows that consisted only of individual transactions less than \$100,000, since several agencies were accepting cards under programs with individual transactions that could range in size from under \$100 to over \$1 million. The Treasury has also entered into agreements with Federal agency Chief Financial Officers to establish goals and metrics for reducing an agency's collections costs by moving transactions to more efficient mechanisms, such as ACH, when it can be done without impairing the agency's ability to deliver services under a program. In some cases, moreover, the Treasury will not offer the option of card collections to an agency implementing a new Federal program when the average transaction amount is too high and would result in exorbitant costs to the Treasury. Lastly, for PIN-based debit card transactions, the Treasury minimizes costs through technology that ensures transactions are routed through the processing network with the lowest effective rate for a transaction.

### THE ISSUE OF CARD COSTS

These actions, while prudent and helpful in containing costs, do not address the core issues of the level of interchange rates and other mandatory fees paid by the Federal government, and how the card networks establish these charges. While the Treasury does benefit, relative to some commercial merchants, from special interchange rates offered only to governmental entities in some instances, these rates are established unilaterally and are not applied consistently across transactions and payment networks. And although the Treasury has held direct and indirect discussions with the card networks over the years in attempts to reduce the Federal government's

card acquiring costs, rates have never been open to negotiation. Thus the Treasury, acting strictly as an acceptor of payment cards and not as a regulator or public policy maker, has been unable to realize acceptable reductions in its interchange rates and must choose between accepting cards at the prescribed rates or not accepting cards as a payment mechanism for a given Federal program.

Denying the public the option of making payment by card, however, is not viable in most cases, since it would mean turning away citizens and businesses that have tendered a card and instructing them to return with cash or check to pay for sensitive or essential government services, such as a small business paying a fee to the Patent and Trademark Office, a veteran making an insurance co-payment to a VA Medical Center, or a medical clinic paying the Department of Health and Human Services to research a physician in the National Practitioner Data Bank. Moreover, card transactions are crucial to the delivery of many government services on-line, where other payment mechanisms may not be feasible. As a matter of both public policy and customer convenience, citizens are, of course, increasingly interacting with their government over the Internet, with on-line card transactions growing 22% in FY 2009.

# NEGOTIATING NEW RATES AND TERMS

The Conference Report to the FY 2010 Consolidated Appropriations Act directed the Treasury "to report to the House and Senate Appropriations Committees...on the potential cost savings and other benefits to the Federal Government if [the Treasury] were able to effectively negotiate (1) changes in the rates and fees assessed by card networks and (2) modifications to the rules and regulations of the card networks which restrict the Federal Government's ability to determine the types of card payments it accepts and the methods by which its transactions are processed." If we accept the premise in the Conference Report – that the current structure of the payment card system has not afforded the Treasury an opportunity to negotiate appropriate prices – then one potential solution to consider is providing the Treasury with a mechanism to restrict or opt out of accepting cards for particular transactions, without incurring a penalty from a card network for violating the rule to accept all cards, if processing the transactions would be contrary to the public interest due to unduly high cost. For example, one mechanism may include granting the Treasury legal authority to establish new standards for processing public financial transactions, similar to the authority the Treasury currently holds to establish standards for depositories that hold public money.

Any such mechanism should not permit the Treasury to compel a card network or member institution to reduce fees, to make special changes in rules or fee structures, to provide any services to the government, or to enter into any agreements with the government. Such a mechanism, including any new legal authority, would only apply prospectively and could be targeted to simply allow the Treasury to establish standards for removing transactions from the cross restrictions in card network rules and to process them through another payment mechanism without enjoining any parties. The widespread restriction of card transactions would be neither the likely nor the desired result from such authority, since the Federal government would still have every incentive from other quarters to let citizens pay by card. However, having the ability to opt out of certain transactions based on cost, which may include options provided under new

legal authority, would allow the Treasury to negotiate pricing terms on behalf of the taxpayer from a more equitable position, since the Treasury would have the credible option of avoiding card transactions where the expense to the taxpayer clearly outweighs any benefits. Any such negotiations for new pricing terms would be conducted separately with each card network on a bi-lateral basis.

### POTENTIAL COST SAVINGS

As we consider potential solutions, there are difficult legal and business questions that must be carefully assessed. Nevertheless, I can provide an outline of several goals the Treasury may seek to achieve if the Treasury could reasonably negotiate costs and certain processing rules with card payment providers. We believe that significant cost savings could be achieved, but also underscore that we are mindful of the complex issues associated with the Treasury's conduct in the payments marketplace. The following terms represent the types of approaches the Treasury could pursue.

First, the Treasury could negotiate to establish a simplified framework for interchange rates. For example, the Treasury might negotiate to create one interchange rate that the government would pay to card networks for all credit transactions, and a separate single interchange rate the government would pay to networks for all debit transactions. The rates would apply regardless of how a transaction is tendered (e.g., card present versus card not present), the type of card used (e.g., rewards versus non-rewards), or the type of Federal collection (e.g., sale of goods, loan repayment, fine, etc.). These uniform rates would displace the current complex of rate categories applied to Federal agency transactions.

Second, the Treasury could seek to have the option of establishing a maximum transaction amount above which an individual credit card transaction would not be allowed. Above certain dollar amounts, credit cards are simply not an appropriate payment mechanism under most Federal programs, especially when the Treasury can process the transaction at considerably less expense with any other paper or electronic payment mechanism.

Third, Treasury could attempt to negotiate reasonable limits or mutually acceptable rules on the card networks' unilateral right to raise or institute new fees. Such reasonable limits are important not only for reasons of equity, but also to ensure that any reductions that the Federal government may realize in total interchange costs are not offset by increases in other mandatory card network fees.

Fourth, Treasury could pursue the right to establish and collect a processing fee from an individual card holder to defray the Treasury's cost of processing a particular transaction. Such a fee would not be used in most cases or with Federal programs with broad public participation, but might be charged in those cases where the cost of unique transactions should be reasonably born by the individual card holder receiving some special benefit and not by the general taxpayer. The amount of the fee would be limited to the cost to the Treasury imposed by a card network for the transaction, and would be deposited into the Treasury as a miscellaneous receipt.

These types of changes in the rate structure and processing rules could be implemented within the current card processing infrastructure, in a manner that is straightforward for issuers,

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acquirers, and card networks. Although cards would still be the Treasury's highest cost collection mechanism, we believe changes like these could allow the Treasury to reduce the Federal government's per transaction card cost by an estimated \$0.45 to \$0.49, which would equate to \$36 million to \$39 million in reduced annual interchange fees based on FY 2009 transaction volume.

### **CONCLUSION**

Mr. Chairman, these remarks are offered from the perspective of the Federal government acting in the role of a service provider that accepts cards, and in response to the direction from the House and Senate Appropriations Committees in the FY 2010 Conference Report. They are not offered from the perspective of a policy maker or regulator with responsibility for the commercial payments system. Moreover, I wish to highlight the difference between a Federal agency accepting cards and a commercial merchant accepting cards. With few exceptions, Federal agencies that accept cards are not engaged in sales for profit, in competitive or market based activities, or even in traditional non-profit activities, but are delivering inherently governmental services to execute Federal law. The strategy I have outlined to reduce the Federal government's card costs is based on this unique role and applies to the interest of the general taxpayer, and not necessarily to merchant interests or any other special interest. While currently there is a larger public policy debate on interchange fees in the broader economy, with many competing interests among banks, merchants, and payment companies, the Treasury's financial managers have a responsibility to conduct fiscal operations as efficiently as possible and to pursue arrangements that afford the lowest costs to the general taxpayer. Toward this end, we welcome dialogue with all users and providers of payment card services.

I thank you for allowing this discussion on the Federal government's cost of accepting credit and debit cards, and look forward to taking your questions.